

STATE OF NORTH DAKOTA
BEFORE THE COMMISSIONER OF INSURANCE

In the Matter of the Promulgation of Proposed Rules)	ORDER ADOPTING RULES RELATING TO CONSUMER CREDIT INSURANCE FILE NO. RU-02-066
)	

THIS MATTER came before the North Dakota Commissioner of Insurance for consideration. The Commissioner, having held a public hearing, having considered the testimony and filed comments of all interested persons, and having been otherwise fully advised in the premises, **FINDS AND CONCLUDES THAT:**

1. The Abbreviated Notice of Intent to Amend Administrative Rules was properly published once in each official county newspaper at least 30 days prior to the date of the hearing.
2. Staff of the North Dakota Insurance Department prepared a proposed rules file, filed it in the docket on January 28, 2002, and made it available to all interested persons.
3. A hearing was held on March 6, 2002, in Bismarck, North Dakota, to take comments on the proposed rules.
4. At the hearing, all interested persons were given a reasonable opportunity to submit relevant oral or written comments and to examine witnesses providing comment at the hearing. The record was held open for additional written comments after the hearing.
5. In promulgating the final version of the rules in the form attached to this Order, the Commissioner considered all testimony given at the hearings and all written comments that have been filed in the docket.
6. Comments concerning the consumer credit rule changes were received from numerous interested persons.

I. CHANGES RELATING TO CONSUMER CREDIT INSURANCE

7. The North Dakota Insurance Department proposes several changes to the present consumer credit insurance regulations. Existing regulations found in N.D. Admin. Code Chapter 45-07-01 are repealed and replaced with a new chapter, N.D. Admin. Code Chapter 45-07-01.1.

Authority

8. N.D. Cent. Code § 26.1-37-08(1) relating to the Commissioner's authority over consumer credit insurance provides:

The commissioner may adopt rules to assure that the premium rates are reasonable in relation to the benefits provided.

N.D. Adm. Code § 45-07-01-02(5) mandates that the Commissioner review consumer credit insurance rates annually to determine whether the benefits offered by consumer credit insurance are reasonable in relation to premiums. It provides:

The commissioner shall maintain year-by-year surveillance over the developing overall loss ratio experienced by each insurer providing credit life insurance or credit accident and health insurance in North Dakota. This loss ratio means the ratio of incurred claims to revenue premiums.

The commissioner will compare this loss ratio of the insurer with the commissioner's standard for the insurer, in order to determine that benefits provided are reasonable in relation to premiums charged. In arriving at this standard, the commissioner will take into account the following considerations: (a) the insurer's total annual premium volume, (b) the insurer's average annual premium volume per creditor account, and (c) any other relevant factors.

The incurred claims and revenue premiums, as used in the above loss ratio, and the annual premium volume, as used in items (a) and (b) above, are those which are derived from the insurer's entire United States business, indirect business only, credit life and credit accident and health combined.

9. The Insurance Department staff proposes a 45% loss ratio standard for the industry which, if met, will be accepted as evidence that benefits provided by a consumer credit insurance company are reasonable in relation to premiums.

10. If a company has not met the 45% loss ratio after three years, the Commissioner may set lower rates as needed or propose other changes to meet the 45% loss ratio.

Present Credit Insurance Loss Ratios

11. Information gathered by the Center for Economic Justice, a national consumer watch group, from annual reports filed by the companies with the National Association of Insurance Commissioners (NAIC) show the following consumer credit insurance loss ratios for North Dakota:

	1995	1996	1997	1998	1999	2000	Average
Life	27.4%	33.0%	32.0%	31.5%	33.5%	24.4%	30.3%
Disability	28.0%	29.9%	41.1%	31.9%	27.0%	33.4%	31.9%
Unemployment	13.5%	9.7%	15.2%	5.2%	5.7%	4.2%	8.9%
Property	49.0%	28.6%	40.7%	14.5%	60.9%	15.5%	34.9%
Total	26.0%	28.1%	32.7%	26.0%	25.9%	23.7%	27.1%

The entire summary is attached as Attachment 1.

12. The summary shows that over the last five years, credit insurance loss ratios were, on the average, only 27.1%, which is considerably less than 45%, the loss ratio the Department staff proposes as the loss ratio for consumer credit insurance products. The Center for Economic Justice argues that a more fair loss ratio would be 60%. It should be noted that the NAIC Consumer Credit Insurance Model Rule proposes a 60% loss ratio.

13. The Commissioner finds that the present loss ratios are not reasonable in relation to premium charged.

14. In a 1995 rulemaking, the Commissioner attempted to address unreasonably low loss ratios in the consumer credit insurance industry by ordering consumer credit insurance companies to reduce consumer credit insurance rates. The industry lowered rates, but at the same time the industry raised underwriting requirements, thereby negating the effect of lower rates. That is, the companies offset the reduced premium by reducing the amount paid out in claims, thereby protecting the company profits. Loss ratios remained unreasonably low.

15. The proposed rules seek to protect against similar company action today by setting a minimum loss ratio of 45%.

Reverse Competition

16. The consumer credit insurance industry has been described as having “reverse competition” that results in higher prices for consumers, as distinguished from “direct competition” that results in lower prices for consumers. To explain this anomaly, the New York State Insurance Department Regulation 27A (11NYCCR185) reads:

185.0(b) In the marketing of credit insurance, the inferior bargaining position of the debtor creates a “captive market” in which, without appropriate regulation of such insurance, the creditor can dictate the choice of coverages, premium rates, insurer and agent, with such undesirable consequences as: excessive coverage (both as to amount and duration); excessive charges (including payment for nonessential items concealed as unidentifiable extra charges under the heading of insurance); failure to inform debtors of the existence and character of their credit insurance and the charges therefor, and consequent avoidance of the protection provided the debtor by such coverage.

(c) In the absence of regulation, premium rates and compensation for credit insurance tend to be set at levels determined by the rate of return desired by the creditor in the form of dividends or retrospective rate refunds, commissions, fees, or other allowances, instead of on the basis of reasonable cost. Such “reverse competition,” unless properly controlled, results in insurance charges to debtors that are unreasonably high in relation to the benefits provided to them.

17. Because of the unusual nature of the industry, it is imperative that the Commissioner set a minimum loss ratio of 45% for the industry.

Component Costs

18. Several commentors argued that the Commissioner should not rely on loss ratios in determining whether or not present rates are reasonable in relation to the benefits provided, but rather should look to the component costs involved in offering the insurance. It should be noted that the agent community has adamantly opposed any regulation of agent commissions—a

primary part of the component costs. Regardless, the companies fail to provide any cost evidence to show that the component costs exceed the costs allowed by this rulemaking or otherwise show that the proposed loss ratio is unfair.

Consumer Complaints

19. Several commentors argued that the proposed rates should not be lowered because no North Dakota consumers have complained. The Department has received occasional inquiries from consumers regarding credit insurance. Those inquiries have not resulted in formal complaints because borrowers did not wish to file a formal complaint. It should be noted, however, that even though consumers in North Dakota may not have complained, national consumer groups such as the Center for Economic Justice have complained. Regardless, the Commissioner has the duty to monitor company loss ratios annually and to set standards so that benefits provided are reasonable in relation to the premiums charged. By this rulemaking, the Commissioner is exercising his authority to set reasonable loss ratio standards for the credit insurance industry.

Three-Year Review

20. One commentor suggested setting a date certain for the Commissioner's three-year review and suggested a date in 2006. The Department agrees and the date will be three years from the effective date of these rules.

Advanced Effective Date

21. Several commentors noted that if the rules are promulgated, the effective date should be advanced so as to allow the companies time to implement the necessary software and other administrative changes that will need to be made. The Department agrees and will set an advance effective date.

Companies Discontinuing Business in North Dakota

22. Several commentors noted that the present rates are now some of the lowest in the

nation and argue that decreasing the rates further will make the products less profitable for the companies, some of which may discontinue selling the products in North Dakota. Others noted that some lenders might discontinue offering consumer credit insurance.

23. The proposed changes will not appreciably discourage companies from offering consumer credit insurance in North Dakota. The rates for credit life and credit accident and health (disability) need not change. Also, relaxing underwriting requirements should result in more consumer insurance policies being sold in this state so that companies and lenders should realize greater gross premiums and profits, even though the profit on an individual policy may be less than before.

Low North Dakota Rates

24. Several commentators noted that the present North Dakota credit life and credit disability insurance rates are among the lowest in the nation. The proposed rules do not change the current prima facie rates for credit life or credit disability. Existing rates have already been deemed to be reasonable by the Commissioner. Rates alone, however, do not determine whether or not the benefits provided are reasonable in relation to the premium charged. The company loss ratio is a better indicator of the fairness of rates because it considers consumer benefits as weighted against prices, as distinguished from prices alone. Even if a company is forced to lower its premiums, it can maximize its profits by limiting benefits through strict underwriting. Even if a company's premiums are low, if benefits paid are negligible, the premiums are unreasonable.

Low Volume Business for Small Banks

25. Several commentators noted that the amount of business written by banks and some auto dealers is relatively small and argue that the banks need high commissions funded by low loss ratios to continue to offer the products. The proposed rules should increase the amount of business written and result in more premium revenue for the banks.

45-07-01.1-01 – Definitions

26. One commentator suggested that the definitions include a definition of “open-end” credit. The term is defined in N.D. Cent. Code § 26.1-37-02(18) and need not be defined here. It should also be noted that as a result of the comments received, the definition of “preexisting condition” has been revised so that it may be used as an exclusion for both credit life and credit disability.

45-07-01.1-03(1) – Deviation Rates

27. A deviation rate is not allowed until a company loss ratio exceeds 60% and commentators noted that there is no “relief” for a company if its loss ratio exceeds 45%, until its ratio exceeds 60%. They note that the proposal rule leaves a gap such that a company cannot request a deviation from the prima facie rates until its loss ratio reaches 60%. This provision is not new. It already exists in N.D. Adm. Code § 45-07-01-02(4). If a company’s loss ratio exceeds 45%, the company is not without a remedy: the company can control its loss ratio by initiating stricter underwriting.

45-07-01.1-04(2)(a)(4) – Terminal Illness Exclusion

28. One commentator questioned what would happen under this section if a death occurred after 13 months of taking insurance. The proposed rule allows a company to exclude credit life coverage if the individual had a terminal illness with an expectancy life of 12 months or less that was diagnosed prior to the effective date of coverage. If the terminal illness was diagnosed prior to the effective date of coverage and if the individual had an expected life of 12 months or less, coverage could be denied, even if death occurred 13 months or more after taking insurance. This provision benefits the industry by limiting the antiselection risk.

45-07-01.1-04(2)(b)(3) – Preexisting Condition Exclusions

29. As originally proposed, this section did not allow for any preexisting exclusion if the amount of credit life insurance was less than \$5,000. One commentator objected to the

\$5,000 limit and suggested that a better limit would be \$500, to guard against adverse selection. To address the concern the Commissioner will revise the proposed rules to allow a company to apply a preexisting condition exclusion to the entire amount of coverage. This provision is now the same as it was in the repealed rules.

45-07-01.1-04(2)(c) – Increasing Maximum Age From 65 to 70

30. This section requires that a product be available to individuals up to age 70. One commentor objected because increasing the age from 65 to 70 increases claims costs dramatically and may encourage fraudulent applications. The Commissioner agrees in part and the rules will be modified to provide that credit life must be available to individuals up to age 70, and that other credit products must be available to individuals up to age 66.

31. One creditor noted that the increased age limit of 70 for credit life is higher than that in other states or as set forth in the NAIC model. The model, however, is almost 30 years old. Life expectancies have increased significantly in that time. It is not unusual for persons to be active and actively employed to age 70. Seventy is a more reasonable age for credit life today.

45-07-01.1-04(3)(c) – Underwriting Allowed if Policy Exceeds \$15,000 for Credit Life

32. Several commentors objected to the proposed provision that allowed underwriting on credit life policies in an amount in excess of \$15,000, but not below. They noted that the different rates would be difficult to administer, especially with respect to open lines of credit. The Commissioner agrees and has removed the two-tiered rating and underwriting provisions in this section for credit life. The rules will be modified to provide that a policy of no more than \$5,000 must be guarantee issue. Also, the first \$5,000 of a policy in excess of \$5,000 must also be guarantee issue. The guarantee issue amount must be made available to all eligible applicants but an insurer may apply exclusions for war, suicide, preexisting conditions, or terminal illness to the entire amount of credit life insurance.

45-07-01.1-04 - Credit Life

45-07-01.1-05 - Credit Accident and Health (Disability)

33. One commentor questioned the rationale for mandating a \$5,000 guarantee issue for credit life and credit disability.

34. The mandate is necessary to assure that the policy benefits are reasonable in relation to the premiums charged. Loss ratio experience provides a basis for determining whether or not benefits are reasonable in relation to the premiums charged.

35. The consumer credit industry is unique in that it has reverse competition. The consumer is not always offered the lowest price product. Creditors selling the products control the product offered to the consumer. Creditors offer those products that maximize the return to the creditor.

36. Enacting new credit insurance rules without imposing a mandated guarantee issue would again allow a company to impose strict underwriting requirements that would limit the sale of the products to only those that pose little risk of collecting benefits. A company's loss ratio would be minimal, the same as is today.

37. The Commissioner could order reduced prima facie rates to increase loss ratios, but historically reducing prima facie rates has not been an effective mechanism for increasing either company or industry loss ratios. This is precisely what happened five years ago when the Commissioner developed prima facie rates but did not impose a minimum guarantee issue. The industry tightened its health standards and reduced its claims paid to hold loss ratios to less than 27%. To avoid the same problem going forward, it is necessary to mandate a minimum guarantee issue for credit life and credit disability of \$5,000.

38. The commentor also questioned how the industry was to control the number of \$5,000 policies purchased by a consumer. The answer lies with the creditor. Each credit insurance sale is tied to a credit transaction, unless otherwise allowed by the creditor. The

consumer will not be allowed to purchase more than one policy per credit transaction unless approved by the creditor.

45-07-01.1-05(2)(b)(3) – Joint Rates

39. One commentator objected to the joint disability rate of 1.7 as being too low and suggested that a more fair joint rate would be 1.95. The Commissioner agrees in part and will modify the rules to set the joint disability rate at 1.8.

45-07-01.1-07(2) – Minimum Coverage

40. One commentator noted that the provision providing for minimum coverage in a credit property policy was problematic because it is not always clear as to what provisions are contained in a “standard fire policy” and suggested deleting the provision. The Commissioner agrees in part and will modify the provision to read:

A credit property policy must at a minimum provide coverage against loss from fire, lightning, riot, riot attending a strike, civil commotion, smoke, aircraft and vehicle damage, windstorm, hail and explosion.

45-07-01.1-08(3) – Refund of Unearned Premium

41. One commentator suggested increasing the threshold at which a refund of unearned premium need not be made from \$2 to \$5, because the costs of issuing a refund exceed even the \$5 amount. The Commissioner agrees and the rules will be revised accordingly.

45-07-01.1-04 and 45-07-01.1-05 – Discount Rate and Credit Life and Credit Disability

42. One commentator questioned the use of 4% as the annual discount rate in subsection 1(b), arguing that the rate is too high in light of today’s low interest rates. The commentator suggested a rate of 2.5%. The Commissioner will adjust the discount rate to 3% for credit life and credit disability.

Regulatory Analysis

43. One commentator argued that the rulemaking process is defective because the

Department did not prepare a regulatory analysis prior to noticing the rule changes, as required by N.D. Cent. Code § 28-32-02.2. That section requires a regulatory analysis if the proposed rule is expected to have an impact on the regulated community in excess of \$50,000. The commentor represents creditors and agents, neither of which are regulated by the rules proposed here. These rules apply to consumer credit insurance companies, none of which have questioned the need for a regulatory analysis.

44. In this rulemaking the Commissioner exercises his rate review authority over consumer credit insurance rates as found in N.D. Cent. Code § 26.1-37-08(1) and N.D. Admin. Code § 45-07-01-02(5). It is not clear from the law relating to regulatory analysis or its legislative history that the law applies to rate review proceedings. That law, subsection 2(d), requires that the regulatory analysis include a description of any alternative method for achieving the purpose of the proposed rules. There are no alternative methods for accomplishing rate reviews. One must conclude that it was not the Legislature's intent that N.D. Cent. Code § 28-32-02.2 apply to the Commissioner's exercise of his rate review authority.

45. Whether or not a consumer credit insurance company will be impacted by this rulemaking will depend more on internal company management decisions than on this rulemaking. A company's revenues and profits depend on many factors, including the number of policies sold, the price, the company's underwriting standards, the company's marketing strategy, competitor's price, competitor's marketing strategy, agent commissions, and others. It is too speculative to find that this rulemaking will, in fact, impact companies by \$50,000 or more.

46. The commentor argues that the industry will incur increased administrative costs involved in updating various software programs to account for price changes. The rules, however, do not require price changes. The present prima facie rates will remain in place with this rulemaking.

47. N.D. Cent. Code § 28-37-08 provides that the regulatory impact analysis must include a description of the classes that will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and the classes that will benefit from the proposed rule. It is not clear from the regulatory analysis law or from the legislative history whether the regulatory analysis should be based upon the expected impact to any one class or whether the regulatory analysis should be based upon the net impact on all classes considered as a whole. It is reasonable to study the net impact on all classes considered as a whole. That impact is a wash. Any negative impact on the companies is offset by a corresponding benefit to consumers through increased benefits.

48. The Commissioner finds that no regulatory analysis is required. This rulemaking imposes duties on insurance companies, not agents or creditors. The companies do not request a regulatory analysis. Furthermore, it is too speculative to conclude that this rulemaking will impact any one company or the insurance companies as a whole by more than \$50,000. It should be noted that this rulemaking will cause no impact on the industry that has not already been authorized by law and by existing rules. N.D. Admin. Code § 45-07-01-02(5) authorizes the Commissioner review the industry loss ratios annually and set standards to assure that benefits provided are reasonable relative to the premiums charged regardless as to the impact on the industry. N.D. Cent. Code § 26.1-37-08(1) allows the Commissioner to adopt rules to assure that premium rates are reasonable in relation to the benefits provided.

Comment - Rulemaking is Arbitrary and Capricious

49. One commentator argued that the rulemaking is “legally flawed” and “unwarranted by any demonstrated factual situation in North Dakota” and that the rules are “arbitrary and capricious”.

50. The commentator argued that there was no evidence produced at the hearing to support the proposed change requiring a 45% loss ratio.

51. The North Dakota Supreme Court considered an identical challenge in Little v. Traynor, 1997 N.D. 128, 565 N.W.2d 766. The case involved a rulemaking by the Workers Compensation Bureau in which it set rates for attorneys that represent claimants before the Bureau. The plaintiffs argued that the record did not support the determination that \$85 per hour was a reasonable fee and argued that the rulemaking was arbitrary and capricious.

52. The Supreme Court noted that when an administrative agency adopts rules under the Administrative Agencies Practice Act, it is acting in a quasi-legislative, not a quasi-judicial, capacity. It noted that legislative facts are not susceptible to the kind of evidentiary proof routinely required to support findings of adjudicative facts.

53. It continued to note that rulemaking is more often policy oriented rather than adjudicatory in nature, so the record upon which it is based need not be as complete as in the adjudicatory situation where traditional fact-finding is required.

54. It further noted that if the rule reflects policy judgments of a generic character that cannot really be “proven” by evidence in an adjudicatory sense, specific factual support is not required. It quoted from other decisions that held that when an administrative agency adopts a rule based on a policy judgment, particularly within the expertise of the agency, and not involving controverted questions of critical fact, it is not incumbent on the agency to present evidence in support of the proposed rule.

55. The Commissioner finds that the argument that the proposed rules are arbitrary and capricious is without merit.

Conclusions

56. In this proceeding the Commissioner exercises his authority over consumer credit insurance rates to assure that such consumer credit insurance benefits are reasonable relative to the premiums charged. As a matter of law, the Commissioner finds that unless loss ratio is at least 45%, the benefits provided by its consumer credit insurance products are not reasonable

relative to the premiums charged.

57. The Commissioner finds that a loss ratio of 45% is a reasonable standard for the consumer credit industry.

58. The Commissioner rejects the argument that the proposed rules and the 45% loss ratio standard are arbitrary and capricious.

59. The Commissioner finds that a regulatory analysis is not required.

60. The Commissioner finds that there is good cause for adopting the proposed rule in the form attached to this Order.

ORDER

IT IS, THEREFORE, ORDERED that the rules in the form attached to this Order be adopted and filed in accordance with applicable provisions of state law to become effective on the date of publication by the North Dakota Legislative Council.

DATED this _____ day of _____, 2002.

Jim Poolman
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